North Carolina Tax Credit for Revitalization of Historic Mill Facilities: Other States' Legislation; Legislative Process; Parameters and Rationale; and Cost and Revenue Projection

by

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1. Introduction

The news hit in October of 2004. Granite Mill in Haw River and Columbia Mills in Ramseur had been bought for salvage. In the same month, it was announced that Cannon Mills in Kannapolis was coming down. There are an estimated 200 mill buildings spread throughout the state of North Carolina. As the textile industry declines, the need for these mill buildings in their current use will decline. How should the state deal with the remaining buildings?

On March 2, 2005, Senators Hoyle and Hartsell introduced a bill to the North Carolina Senate titled “An Act to provide a tax credit for revitalization of historic mill facilities and to allow tax credits for certain historic rehabilitations to be transferred to long-term lessees.”[1] This bill has been researched and crafted by a dedicated group of professionals to help restore these endangered mill buildings and other large historic mill buildings throughout the state. I was a part of this group. After doing background research, and estimating the costs and benefits of the bill, I recommend that it be passed. The bill achieves substantial preservation and economic distribution benefits for a relatively small $20 million over the next five years, or $4 million per year for the next five years.

This master’s project is an analysis of all aspects of the “Mills Bill” as it has come to be known colloquially. Section 2 considers some other mill preservation legislation that has been passed in other states. Section 3 details the process of political process through which this bill traveled to its current place in front of the Senate Finance Committee. Section 4 explains the key parameters of the bill and the rationale behind those parameters. Section 5 presents a detailed cost and revenue projection for the state

[1] Senate bill #352

of North Carolina as a result of the bill. Finally, in Section 6, I provide some concluding remarks thoughts about the bill.

2. Other State's Incentives

2.1 South Carolina

In May of 2004, South Carolina passed a law called the "South Carolina Textiles Communities Revitalization Act."[2] The deflating textile industry in South Carolina left many large buildings throughout the state vacant. The primary rationale for South Carolina's effort was economic development. The text of the law claims that vacant textile mills result in:

1. increased cost to local governments by requiring additional police and fire resources due to higher vacancies;
2. disruption of communities;
3. inadequate public and private investment;
4. growth in delinquencies and crime;
5. abnormal exodus of families and businesses; and
6. an overall impairment of the value of private investment.

The law suggests that redevelopment of vacant mills and other ancillary manufacturing facilities will help to cure some of the aforementioned problems. South Carolina uses tax credits as its mechanism to incentivize redevelopment of vacant mills. Below I will discuss how some of the key provisions of South Carolina's tax credit bill work.

2.1.1 Eligible Sites

To be eligible for South Carolina's textile mill a site must meet the following requirements:

[2] All references to parameters and text of this South Carolina law come from South Carolina 1976 Code of Laws, Title 6 Chapter 32.

1. The site must be designed for or have been used as a textile facility or some use ancillary to a textile facility.
2. It must be located in South Carolina.
3. It must be at least 80% vacant for 1 year prior to its identification as a tax credit eligible site.

The requirements of this bill are particularly targeted because the bill piggybacks off of existing tax credit legislation. The bill requires 80% vacancy for at least one year to ensure that eligible buildings are truly a blighting influence on surrounding areas. Limiting eligibility to textile uses ensures a limited possible universe of buildings to which the credit may apply and focuses the subsidy on this particular struggling industry. This is important to the state of South Carolina because it allows the government to accurately estimate the costs of the bill and focus the incentive on buildings associated with a specific declining industry.

A careful reading of the law reveals that South Carolina is not only focused on historic properties (properties 50 years or older; or those listed on the National Register). While this provision opens the tax credit up to many more possible buildings, it is a concern to officials at the South Carolina Division of Archives and History. In South Carolina, the Division of Archives and History is responsible for reviewing historic tax credit applications to ensure they are consistent with the Secretary of the Interior's Standards for Rehabilitation. South Carolina's textile mill credit gives the Division no reviewing authority over project work. Under this law, it is conceivable that the developer of a historic mill would choose to ignore the historic credit and the Secretary's

Standards, while claiming the textile credit instead.[3] This lack of review process also leads to some concerns for the Department of Commerce. Individuals and entities claim the credit through their state income tax returns at the end of the year. Because there is no primary reviewing authority, there is no mechanism in place to predict how many credits the state will be responsible for in a given year.[4]

2.1.2 Tax Credit Mechanisms

The South Carolina textile mill credit gives users the flexibility and choice to take the credit against property taxes or against state income taxes. The mechanism that a user elects leads to very different consequences.

A developer who takes the income tax credit gets a credit equal to 25% of the rehabilitation expenses incurred.[5] If a site also qualifies for the state historic tax credit, then the textile credit is meant to be taken in addition to the existing historic credit. When taken using this income tax mechanism, the credit must be spread over a 5 year period, rather than all at once in the year that the property is placed in service.[6]

A developer who takes the credit against property taxes has a more unpredictable experience. While the bill allows for up to 75% of property taxes to be forgiven for a period of up to 8 years, the ultimate decision-making power is in the hands of the relevant municipality or county. When a developer elects to take this credit, the relevant local

[3] Johnson interview, 2005.
[4] Johnson Interview, 2005.
[5] "Rehabilitation Expenses" in the South Carolina bill is slightly different than the more common "Qualified Rehabilitation Expenses (QREs) that apply to Federal Rehabilitation Tax Credit calculations. Because the SC bill applies to more than just historic sites, Rehabilitation Expenses is defined in the bill as "expenses incurred in the rehabilitation of the eligible site, excluding the cost of acquiring the eligible site or the cost of personal property maintained at the eligible site." An implication of this is that some expenses such full-scale demolition could potentially counted as Rehabilitation Expenses (Johnson Interview, 2005).
[6] I discuss in Section 4.6.3 how taking the credit over a 5 year period reduces the value of the credit to a potential investor. but it benefits the state government by making the tax credit not only low cost, but a positive Net Present Value proposition for the state government, i.e., the state makes money on the tax credit spread over 5 years.

government has the power to determine the eligibility of the site in question. The local government must also determine the amount of property tax and length of forgiveness period by passing an ordinance and giving notice to other affected taxing authorities so they may object. Thus, the period of forgiveness may be fewer than eight years and the percentage of forgiveness may be less than 75%.

2.2 Rhode Island

The state of Rhode Island has a set of coordinated incentives that are to be applied to Certified buildings known as the "Mill Building and Economic Revitalization Act".[7] In order for a building to be Certified, a local government must identify buildings with the most potential for redevelopment. They then present those buildings to the state for certification. Once a building is certified, it is elgible for a creative battery of tax credits that are discussed in detail below.

2.2.1 Industrial Commercial Buildings District

In the mid 1990s, Providence, RI saw a declining downtown with many large buildings left vacant and dilapidated. When a number of historically significant buildings, including Eagle Square, were lost, the political climate was set to do something to preserve the city's most important large buildings. The Providence Preservation Society worked in conjunction with city government and the State Historic Preservation Office to establish the Industrial Commercial Buildings District (ICBD). This is the first thematic-based local historic district established in the country.[8] The Providence Preservation Society surveyed 220 commercial and industrial buildings that might be considered contributing the Industrial Commercial Buildings District (ICBD) and put

[7] All references to parameters and text of this Rhode Island law come from Rhode Island General Laws, Chapter 42-64.7..
[8] Harrington interview, 2005.

them on a Study List. Since the establishment of the ICBD, six buildings have been successfully Certified for participation with the state's special mill incentives. Providence is not the only city with Certified sites, but it is worth noting because it is a concerted effort to designate properties on a larger scale than at the individual property level.

2.2.2 Incentive Mechanisms

Rhode Island's mill incentive is actually a battery of incentives meant to benefit not only property owners, but business occupants and lenders as well. This paragraph focuses on the incentives available to building owners.[9] Rhode Island offers building owners a tax credit equal to 10% of Qualified Rehabilitation Costs. This credit is offered in addition to the 30% Historic Rehabilitation credit that the state of Rhode Island offers for a combined incentive valued at 40% of QREs. The credit must be taken within 2 years of Certification. The entire credit may be taken in the first year that the building is placed in service. This is a major benefit to the building owner because it increases the value of tax credits in the syndication market, giving the owner a high level of tax credit equity.[10] The building owner may carry forward the credit for 8 years if he is unable to use the entire credit in year 1.

Rhode Island also offers an incentive for lenders. Lenders who finance rehabilitation expenses on a Certified building may earn tax credits on 100% of interest on these loans up to $20,000 per year. In principle, this is a very generous credit because it allows a lender to take a dollar for dollar credit on all interest paid on all loans to Certified buildings.

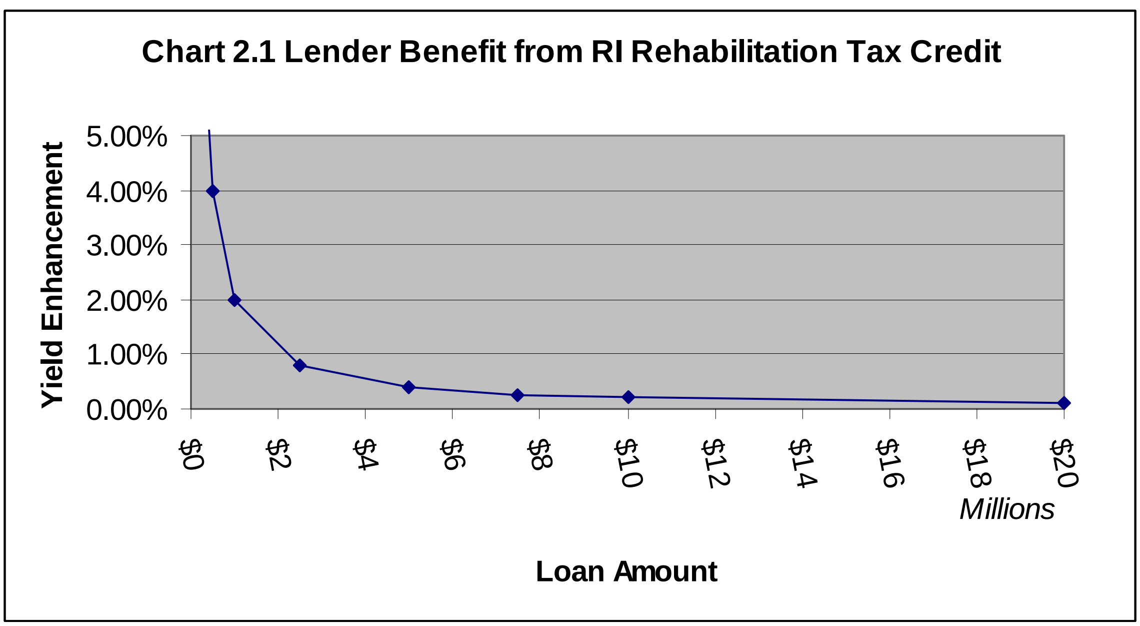
[9] This incentive mechanism is most comparable to the South Carolina and proposed North Carolina credits.
[10] See Section 4.6.3 for clarification of this point.

The $20,000 cap limits the effects of the credit; however, because of the large size and rehabilitation expenses associated with Certified mill buildings. Table 2.1 and Chart 2.1 show the strong negative correlation between loan amount and yield enhancement that the credit earns a lender. In North Carolina, a typical mill would average $8 million in rehab expenses. As Table 2.1 shows, a loan amount of $7.5 million would only grant a lender 27 basis points in yield enhancement. While this is beneficial to a lender, it is hardly the type of incentive that would push a lender from a no-lend to a lend decision.

Table 2.1 Lender Benefit from Rehabilitation Tax Credit

Loan amount	$250,000	$500,000	$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000	$20,000,000
Annual Payment	$23,598	$47,196	$94,393	$235,982	$471,965	$707,947	$943,929	$1,887,859
Year 1 Interest	$17,500	$35,000	$70,000	$175,000	$350,000	$525,000	$700,000	$1,400,000
Year 1 Principal	$6,098	$12,196	$24,393	$60,982	$121,965	$182,947	$243,929	$487,859
Credit amount	$17,500	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000
Yield Enhancement	**7.00%**	**4.00%**	**2.00%**	**0.80%**	**0.40%**	**0.27%**	**0.20%**	**0.10%**
Total Yield	**14.00%**	**11.00%**	**9.00%**	**7.80%**	**7.40%**	**7.27%**	**7.20%**	**7.10%**

Amortization	20	years
Interest Rate	7%	



Rhode Island offers lenders a similar incentive for loans made to businesses occupying space in a Certified building. The credit equals 10% of interest on these loans up $10,000 per year. This creative incentive, while shallow, allows the state to work towards the success of all aspects of the rehabilitation of a Certified building.

Finally, Rhode Island offers incentives to businesses that located in a Certified building. This credit is equal to 100% of wages paid to each new employee up to $3,000. If the Certified building is also located in an Enterpise zone, then the credit is equal to 50% of wages paid to each new employee up to $10,000.

2.2.3 Discussion

Rhode Island's battery of incentives aimed at the successful rehabilitation of commercial and industrial buildings is an impressive attempt at affecting all key stakeholders in a Certified building. Mary Kate Harrington of Preserve Rhode Island suggests that the program has been proven successful; the legislation was renewed in 2002 after 8 years of implementation.[11] Success has been reached from both a preservation and an economic development perspective. Because of this, it is a valuable model to consider different mechanisms that North Carolina might be able to utilize for effective legislation.

[11] Harrington interview, 2005.

3. North Carolina Mill Incentive Process

No discussion of the creation of a bill would be complete without an idea of the political process that was necessary to get the bill created and passed. I was fortunate to assist Myrick Howard of Preservation North Carolina as he worked to make a mill rehabilitation incentive a reality. This section describes the process and some of the key political lessons to be learned from it. Table 3.1 outlines the highpoints of the political process to date.

Table 3.1 Process Timeline	
10/24/2004	Shortlist of coalition candidates created
10/25/2004	First meeting with Deborah Ross to discuss political strategy
11/12/2004	Shortlist invited to first meeting
12/10/2004	Meeting of coalition to determine rationale and parameters of mill incentive
12/21/2004	Outline of Textile-Tobacco-Furniture Credit Parameters circulated
1/10 - 1/25/05	New ideas for parameters suggested and debated by the coalition
2/2/2005	Preliminary cost estimates calculated
2/3/2005	First draft of bill created
2/3/2005	Meeting with Deborah Ross about bill specifics
2/4 - 2/22/05	Bill drafting by state government
2/18/2005	Second meeting of coalition to reach consensus and refine changes to parameters
2/23/2005	Meeting with Senator Hoyle to ask for sponsorship
3/1/2005	Meeting with Senator Hartsell to ask for sponsorship
3/3/2005	Senate bill 352/House bill 474 filed
3/12 - 4/7/05	Detailed bill cost estimate created and refined
4/22/2005	Senate finance committee calls for fiscal note on bill

3.1 Coalition Creation

The process began with the creation of a coalition. This group was to have enough knowledge and experience to easily identify the best structure for the bill and the best way to guide it through the political process once created. The group consisted of a balance of rehabilitation developers, preservationists, lenders and financiers, tax credit attorneys, NC community interests, and state legislators (See Appendix 1). We were advised on political strategy by Deborah Ross, a democrat in the House of

Representatives. In late October, 2004, we created a shortlist of 15 individuals to meet to discuss potential parameters of the incentive.

3.2 Initial Meeting

Fourteen individuals attended our meeting scheduled for 12/10/04. During the meeting, Mr. Howard presented information on political strategy and I presented information about other states' mill incentives (See Appendix 2). The meeting moved to a brainstorming session in which we suggested and debated many different ways the bill could be structured. The meeting moved from brainstorming to settling on a basic structure that was agreeable to the group (See Appendix 3). The meeting lasted for approximately 4 hours.

3.3 Idea Refinement

The break over Christmas evidently gave coalition members some time to think more deeply about the parameters of the bill. I asked the group if they felt comfortable with the parameters of the bill. I received one request to expand the scope of the bill from Textile, Tobacco, and Furniture, to include "Agricultural." This touched off a flurry of discussion about pros and cons of expansion of the bill, but especially what was the appropriate building type the credit should be applied to.

There were two contradictory forces directing the discussion. We had been guided by Deborah Ross to ensure that we could limit the scope of the bill to a finite number of buildings. This would allow the legislature to get comfortable with the bill because they would be able to confidently estimate the short-run costs of the bill. This is especially important in North Carolina's budget-constrained political environment. On the other hand, there was a general preference by the group to expand the scope of the bill to ensure that many buildings would be preserved by the pending legislation. This discussion steered the group away from consensus as they considered more and more options to limit the bill rather than focusing on one or two ideas. Ultimately, a tighter consensus was reached in mid-February (after additional political guidance) when we held a follow-up meeting with eight members of the coalition to consider bill drafts and finalize key parameters, especially how to limit the scope of the bill to a finite universe of buildings (See Appendix 4 for the results of this second meeting).

3.4 Bill Drafting

One of the members of our coalition, Todd Brockmann, is a tax credit attorney with The Brockmann Law Firm, PLLC in Charlotte, NC. He had drafted South Carolina's "Textiles Communities Revitalization Act." As such, he was very familiar with both the language and provisions of that bill. Mr. Brockmann volunteered to write the first draft of the North Carolina mill bill, as it came to be known. He wrote the first draft by February 3, 2005 (See Appendix 5).

We brought this draft to Deborah Ross and Canaan Huie, a bill drafter for state government. We explained the basic provisions of the bill, the discussions that we had had with the coalition, and our initial cost estimates for the bill. Canaan Huie took the draft bill and worked with through five iterations, gathering input from the coalition and ensuring that the bill interfaced accurately with existing laws on the books.

3.5 Political Meetings

Mr. Howard and I had a meeting on October 25, 2004 with Deborah Ross to discuss strategy for getting the bill through the state legislature. She defined our research mission clearly: we must be able to define the universe of buildings to which the credit would apply. This was essential because it would allow us to estimate the costs of the bill with some certainty. Our next task was to identify other states in which similar legislation has been passed. Finally, she strongly suggested that we get the draft bill through the Senate first, and then pass it through the House. Passing the bill through the Senate gave it a better chance to get through cleanly. Once it had passed one branch of the legislature cleanly, it could always revert to its original form. Her fear of bringing it through the House first was that the bill would be unrecognizable if it passed at all.

Our second meeting with Deborah Ross allowed us to present some answers to her questions about what other states are doing and what the possible costs could be.[12] We also presented our draft bill and could discuss in detail the ideas that the coalition had had about how to make the bill most effective. Ms. Ross suggested that we get Senators Hoyle and Hartsell to sponsor the bill in the Senate because they are both instrumental to the Finance committee and well-respected Senators whose districts could gain from this legislation. She also recommended that we work for support from Ham Horton.

Since I came to North Carolina in 1995, I have learned many things about culture in this state. Our meeting with Senator Hoyle was, perhaps, the culmination of my enculturation. The meeting was scheduled for 10:00 am on February 23, 2005 and when we arrived, Senator Hoyle was not in his office. Mr. Howard struck up a friendly conversation with Ms. Williams, Senator Hoyle’s assistant at the front desk. The conversation was peppered with efforts to find common ground, compliment Ms. Williams and let her share her opinions about historic preservation. Mr. Howard was as polite as ever when Ms. Williams told him that her son had moved a historic home from

[12] Section 2 discusses our information about what other states our doing. This is the same information that we relayed to Ms. Ross. Section 5 discusses our cost estimates of the bill.

NC to Charleston, SC to restore it![13] When Senator Hoyle finally arrived at 10:35, some lobbyists attempted to get his attention, but Ms. Williams ensured that we had our meeting. Senator Hoyle was harried, but welcomed us into our office. The meeting itself lasted for about 1 minute and included an exchange like this:

Sen. Hoyle: "So what do you want to do?"
Mr. Howard: "We'd like to extend the state historic tax credit to give an additional credit to large, vacant mills and other industrial buildings."
Sen. Hoyle: "Sounds good. How much is it going to cost?"
Mr. Howard: "About $7-8 million per year over the next 4 years, including no cost in this coming fiscal year."
Sen. Hoyle: "Well, who else is sponsoring it?"
Mr. Howard: "Deborah Ross is on board. We are going to talk to Senator Hartsell after we talk to you."
Sen. Hoyle: "If Sen. Hartsell sponsors it then I will too."
Mr. Howard: "Thank you, Senator."

We then walked out and had another 30 minute exchange of pleasantries with Ms. Williams. Those conversations created an ally in Ms. Williams to ensure that our messages and our requests got right through to Sen. Hoyle. On the surface it would appear to be a waste, but it was an hour well-spent.

The meeting with Senator Hartsell was more like I would have expected a meeting with a Senator would be. We spent 30 minutes talking about the rationale and particulars of the bill. He had a very strong grasp on the bill and was very supportive. He also asked who else is supporting the bill and we told him that Senator Hoyle would sponsor if he did. He gave us his blessing on the bill at the end of the meeting.

3.6 Cost Estimation

[13] Myrick Howard is president of Preservation North Carolina, an organization dedicated to the preservation of endangered structures throughout the state of North Carolina. It is a truism in preservation circles that moving a building is an absolute last resort, but moving a house from North Carolina to South Carolina simply for aesthetic purposes would be a travesty.

I created two separate cost estimates of the bill. The first was an initial cost estimate based on data on the number of buildings that would likely be eligible. These data were provided by the State Historic Preservation Office. We used this cost estimate to get conversations going with legislators. Then we created a more detailed set of cost estimates that incorporated much more information and assumptions[14]. We worked with the group to refine the assumptions made in this model. After that, we sent our model to the state government's fiscal office. The Senate finance committee recently requested a fiscal note on the mill bill. They used our model, changing only 1 of the many assumptions.

[14] These cost estimates are explained in detail in Section 5

4. North Carolina Mill Incentive Parameters

In Section 3, I described the meetings of the coalition and the process of idea refinement that led to the final version of the mills bill. In Section 2, I described some incentives that are being used in other states to aid in the rehabilitation of large mills and commercial buildings. In this section, I will discuss some of the key parameters that were considered in the process and why they are important. I will also focus on the key parameters of the final version of the bill and explain the rationale behind them.

4.1 Building Types

Perhaps the primary decision made in the process was the type of buildings to which the incentive should be applied. Many building types were considered. At the outset, everyone agreed that the bill should apply to some sort of large buildings. Mills were the obvious choice because of their high profile throughout the state. School buildings were considered. There was a strong preference to follow the lead of South Carolina and apply the bill to buildings of a certain use, regardless of whether the building was historic.

While many building types were considered, we ultimately settled on buildings that were used for manufacturing, uses ancillary to manufacturing, or for providing utility services. The reasons for this decision were numerous. We understood that the identifying these building types would have the potential to save a number of buildings, but, with the State Preservation Office's help, we were able to estimate the number of historic buildings there were in this category.

We limited the buildings to historic for a few reasons. The first was that it would allow the bill to focus on historically significant buildings that are threatened; this was one of the main rationales for going through with the effort to create the bill. The second is that it would allow us to estimate the costs of the bill because there is a finite universe of historic buildings of the uses we were targeting. Finally, it allowed us to utilize existing administrative structures (State Historic Preservation Office) to evaluate projects and administer the credit. This reason was politically important because it ensured that we would add no additional administrative costs to the state budget as a result of the bill. It also allowed us to avoid one of South Carolina's main worries about the bill: that the unmonitored rehabilitation credit would lead to unpredictable costs for the state, and rehabilitation work inconsistent with the Secretary of the Interior's Standards.

4.2 Capitalized vs. Operational Subsidy

The coalition's early conversations were informed by the incentive structures in South Carolina and Rhode Island. A number of the developers in the group claimed that capitalizing a project in the development stage is not terribly difficult because of the existing federal and state rehabilitation tax credits available. They argued that the biggest challenge for "hard" projects located in poorer and smaller markets is getting them to cash flow as they move towards stabilized operations. A key problem is that market rents are low in these areas. Therefore, an incentive that gives a boost to operational expenses rather than capitalization would be a big help. Some ideas that were considered include 1) property tax abatements, 2) tax credits that go straight to the tenants in eligible buildings, 3) tax credits that can be applied to property taxes.

While these ideas were valuable considerations, the group came to the realization that funding developers directly into the project is still the most efficient mechanism for pushing a project into feasibility. Developers could use the extra capital up front to fund an operating reserve that could fill the gap in operational expenses on a stabilized project. The group turned back to the traditional tax credit structure for this reason and because it would be politically expedient to piggyback off of the current, successful tax credit legislation.

4.3 Vacancy Test

The group agreed that South Carolina's vacancy test was a good idea. The point of the bill is to give the "hard" projects a boost while the "easy" ones have already been helped by the existing historic and the real estate market. It was recognized that many of the "hard" projects would be located in smaller, poorer counties. Because it was a political consideration to ensure that benefits of the credit were spread throughout the state, the group believed that a vacancy test would help this cause. We ultimately decided to extend the vacancy test beyond South Carolina's 80% vacant for 1 year to 80% vacant for two years. The idea behind this change was to make the vacancy test a true indication of a downtrodden project. It is conceivable that a developer might be able to carry a project vacant for one year nearly vacant in order to benefit from the mill bill credit, but it is very unlikely that a developer would intentionally carry a project for two years to use the mill bill credit; the interest expense would be crushing.

4.4 Urban Counties vs. Rural Counties

Political, economic, and preservation interests aligned in the goal to spread the effects of the mills bill throughout the state. Spreading benefits throughout the state would help the bill in its political ride through the House and Senate—giving legislators from all parts of the state a reason to support the bill. Economic development was a key rationale behind the bill. The poorest counties of the state, those in tiers 1-3, have the most pressing economic concerns so it is critical that these markets with low rents would have a chance at mill redevelopment. Preservationists recognize that there are historically significant large buildings throughout the state that are threatened by poor markets, high construction costs, and increasing values for salvage materials. Therefore, all interests were aligned in finding a way to ensure that benefits are spread to rural as well as urban counties.

To achieve this goal, the bill included a provision that created a sliding scale for tax credits depending on the location of the building. Eligible buildings in tiers 1-3 would receive a tax credit that is 10 percentage points higher than eligible buildings in tiers 4-5. Table 4.1 summarizes the credit amounts available for different types of properties in located in different tiers.

Table 4.1 Tax Credit Amounts by Tier and Type			
		Tiers 1-3	**Tiers 4-5**
Type	Income producing	40%	30%
	Non-income producing	50%	40%

4.5 *Building Size*

The intent of the mills building was to apply to large, vacant buildings. Size can be measured by square footage or total project costs. Our initial thought was that we would give a square footage criterion to measure size because it is straightforward. This was an impractical approach; however, because size of buildings is not routinely tracked by the State Historic Preservation Office. Therefore, it was difficult to get a sense of what the proper limit in size would be in terms of square footage. How would we know that we crafted the bill to benefit buildings of an appropriate size?

A minimum of $2 million in qualified rehabilitation cost was chosen as a better measure for building size for a few reasons. First, QREs were routinely tracked as a part of the tax credit approval process. This ensured that no new administrative burden would be created and it would be possible to reliably estimate the costs of the bill. Next, QREs ensured that the buildings that were in serious disrepair would receive the attention that they deserve. Two buildings of the same square footage could have very different rehabilitation costs depending on the existing conditions of the building. Finally, because the mills bill was intended to lead to economic development benefits, limiting the use of the credit to projects above $2 million in QREs would ensure that a substantial number of dollars are spent directly in the community where the building is being rehabilitated.

4.6 Tax Credit Syndication Market Value

Tax credits allow the state to make an indirect investment into redevelopment projects through the syndication market for tax credits. $1 in state tax credits is not equal to $1 in direct investment into a development project. In fact, the market for North Carolina State tax currently values them at approximately $0.48 per $1 in state tax credits created by the project.[15] State tax credits are discounted by the market because of their risks, illiquidity, and lack of immediate pay-in. The group recognized that anything that could be done to improve the value of North Carolina tax credits on the syndication market would make them function as a more efficient and effective tool. In other words, if we could increase the value of credits to over $0.50 or $0.60 per credit, more value would be shunted directly into rehabilitation credits. Interestingly, increasing the efficiency of the tax credit would be a revenue neutral proposition for the state

[15] Market estimate comes from the pricing available to the Heilig-Levine project in downtown Raleigh. This is a tax credit rehabilitation project by Empire Properties for which I syndicated tax credits 2 months ago to fill a gap in finance sources.

government and would attract more investment into the state from companies and individuals looking to reduce their tax liability.

4.6.1 Recapture Risk

State tax credits, like federal tax credits carry recapture risk. First, a project must retain the same ownership structure for a 5 year period before the project hits disposition. If ownership changes during this period, the remaining tax credits available will be recaptured, but the equity has already been paid into the project up front. Next, historic rehabilitation projects must stay true to the Secretary of the Interior's Standards for Rehabilitation. If a project is damaged or defaced to be inconsistent with the Secretary's standards, it could trigger a recapture event. The mills bill does not have any provisions to reduce recapture risk. Recapture is a significant part of current rehabilitation tax credit legislation. Attempting to eliminate recapture risk would be too much of a departure from the existing tax credit to easily piggyback off of it.

4.6.2 Illiquidity

There are a number of ways that current tax credit legislation reduces the liquidity of tax credits. In order to utilize rehabilitation tax credits an entity must either be an owner of the project or a master tenant with a 35 year lease in the property. Requiring a substantial interest in a property for an entity to use tax credits creates transactions costs that drag the potential efficiency of the credit.

The existing North Carolina rehabilitation tax credit can only be used against state income tax. This limits the pool of potential syndication investors almost exclusively to banks. Reducing the pool of potential investors reduces liquidity of an asset, thereby reducing its value further. The coalition addressed this problem directly in the mills bill by opening it up to premiums tax (for insurance companies), franchise tax, and income tax. An investor using the mills bill tax credit must the type of tax he would like to apply it against. Once this election has been made, the decision is binding on the investor.

4.6.3 Time to Pay-In

A major impairment to the value of the existing North Carolina rehabilitation tax credits is the time over which they may be used. Current legislation only allows for the credit to be taken over a five year period, e.g., if $100 in state tax credits were earned, only $20 could be taken each year over the next five years. See Table 4.2 for an example of how the pay in period reduces the net present value of $100 in tax credits paid in over 5 years.

Table 4.2 Net Present Value Effects of Pay-In Period					
Year	**1**	**2**	**3**	**4**	**5**
Tax Credit Pay-In	$20	$20	$20	$20	$20
Discount rate	5%	10%	15%	20%	
Net Present Value	$90.92	$83.40	$77.10	$71.77	

The coalition decided to change this provision in the mills bill by allowing the entire credit to be taken in the year that the building is placed in service.

4.6.4 Mills Bill as Demonstration Project

While the primary goal of the mills bill is to save endangered bills throughout the state and engender economic development, it is also a demonstration project for changes to tax credit legislation in North Carolina. The changes described above, taking the credit in one year and opening the credit up to other types of state tax burden should work to make tax credits a more efficient vehicle for rehabilitation. The coalition decided to make these changes modest and to keep the bill separate from existing tax credit legislation to see how the changes affect the value of the tax credits on the syndication market. If values for these credits reach prices above \$0.50 or \$0.60, the bill will be viewed as successful. At this point, the coalition may get together again to consider further changes to existing tax credit legislation, based on the success that these changes engendered.

5. North Carolina Mill Incentive Cost Estimate

One of my most important contributions to the effort to create and pass the mills bill involved creating a detailed cost estimation model. This model estimates both the costs and revenues generated by the mills bill over the next 5 years. It takes a large number of assumptions and distills the assumptions into a single number: the net present value of the mills bill from the state of North Carolina. The best available set of assumptions estimates the total rehabilitation costs encouraged by the mills bill at $261,372,858 while the net present value of the mills bill at -$20,163,721 over the next 5 years. This means that it costs the state approximately $20 million in today's dollars to pass the mills bill, or $4 million per year over the next 5 years. See Appendix 7 for the entire cost estimation model, including assumptions and cash flows over the next 5 years. For convenience, I place some pieces of the model in the text of this Section.

5.1 Key Assumptions

<u>5.1.1 Mill Profile</u>

I analyzed historic rehabilitations over $2 million in rehabilitation costs over the past 3 years using data provided by the State Historic Preservation Office. There were 21 projects of this size over the last 3 years. Because its $85 million rehab costs were so unusual compared to the rest of the buildings done, American Tobacco was excluded from my analysis. Therefore, there was an average of 6.7 large buildings rehabilitated per year over the last 3 years. The average cost of a mill rehab was $8,947,741 while the median cost was $7,687,437. The model estimates cash flows based on median mill rehabilitation cost because our coalition was surprised at the high costs in the average. The median was closer to the coalition's expected typical rehabilitation cost.

Table 5.1 Mill Profile			
	# of Mills	Rehab costs	Total per year
>2 million <5 million	2.7	$3,599,589	$9,598,904
>5 million <10 million	1.3	$6,877,402	$9,169,869
>10 million <20 million	2.3	$13,870,034	$32,363,413
>20 million	0.3	$25,558,260	$8,519,420
Total per year	6.666666667		**$59,651,606**
Average mill rehab		$8,947,741	
Median large rehab		$7,687,437	

From experience, the coalition helped defined the types of uses that rehabilitated large buildings would ultimately have. We estimated that 60% of space would be commercial, 20% residential apartments, and 20% residential condominiums. We estimated that the velocity of mill rehabilitation would be slow at first, and grow over time as developers got used to using the new credits. Therefore, we assumed that mills using the credit would build 5, 6, 7, 8, 9 from fiscal year ’05-06 to ’09-10. Finally we assumed that it would take 1 year for a mill rehabilitation to go from start to finish where finish is defined as being placed in service. While it is likely that it will take 18-24 months for buildings of this size, a one year rehabilitation works for modeling convenience. It allows me to demonstrate the lag between revenues earned and costs incurred by the state—the state earns all revenues before it ever pays any costs because the building must be placed in service before tax credits can be used.

5.1.2 Revenue Assumptions

While it is true that the state of North Carolina bears a cost because of forgone tax revenues from the mills bill, it is also important to consider the revenues that are created as a result of the bill (See Table 5.2 for revenue assumptions). The bill creates jobs directly as a result of the rehabilitation work done. I assume 41.6 jobs per $1 million in rehabilitation expenses. The bill also creates sustained jobs in the rehabilitated commercial space. I assume that there is one job per 250 sf of commercial space, following the GSA's guideline for employee office space usage.[16] From these jobs created, North Carolina earns income tax at an assumed rate of $1,400 per job per year. The state also receives sales tax on materials used in rehabilitation and I assume 30% of rehab expenses are materials subject to sales tax. Finally, the state indirectly benefits from direct and indirect property tax increases encouraged by the rehabilitation of large buildings. I estimated the state's NPV discount rate at 5% because it is about 80 basis points higher than the current 10 year Treasury rate. I assume that the Treasury rate will go up and that the state can borrow at this risk-free rate.

Table 5.2 Revenue Assumptions		
Direct rehab jobs	41.6	per $1 million in rehab expenses
Indirect jobs created by businesses in space	1	per 250 sf commercial space
Direct income tax increase	$1,400	per job created
Sales tax	7%	
Percent of Rehab expenses subject to sales tax	30%	rehab expenses
Property Tax assessed direct value increase	80%	rehab expenses
Surrounding property tax assessed value increase	50%	rehab expenses
Property tax rate	$1	per $100 in tax assessed value
Net Present Value Discount Rate	5%	

5.1.3 Cost Assumptions

The fundamental, underlying assumption behind the model is that no project that utilizes the mill credit would have otherwise happened without it. Therefore, I estimated the costs to include both the existing historic rehabilitation tax credit as well as the mills bill credit. I assume that all credits can be used by an investor in 1 year because the proposed mills bill allows for the combined credits to be taken in 1 year. Condo credits are assumed to be taken over 7 years because they are typically used by individual

[16] In *Real Property Performance Results,* the GSA recommends 230 sf per office user. I use 250 per office user to remain relatively conservative on revenue generation and to allow for vacancy.

investors. The average individual does not have enough tax liability to use all of the credits without carrying them forward over more than 5 years.

Table 5.3 NC State Tax Credits		Years to use credit	
Federal Historic	20%	1	year(s)
Existing NC Historic (Income producing)	20%	1	year[s]
Existing NC Historic (Residential condo)	30%	7	year[s]
Tier 1-3 Mill (Income producing)			
Income producing	20%	1	year[s]
Non-income producing	20%	7	year[s]
Tier 4-5 Mill			
Income producing	10%	1	year[s]
Non-income producing	10%	7	year[s]

5.2 Costs of the Mils Billl

Table 5.4 details the costs of mills bill credit. Although there are $38 million of rehabilitation expenses in the first year of the program, the state bears no cost for the program because none of the buildings is placed in service until fiscal year ’06-07. Costs for non-income producing buildings are so much lower than income producing buildings because those using the credits take a longer time to use them. It is not until a credit is used that it costs the state any forgone revenue. Costs to the state grow in lock-step with the increased rehabilitation over time.

Table 5.4 NC State Cost					
FY	**05-06**	**06-07**	**07-08**	**08-09**	**09-10**
Rehab expenses	$38,437,185	$46,124,622	$53,812,059	$61,499,496	$61,499,496
Existing Historic Credit					
Income producing	$0	$6,149,950	$7,379,940	$8,609,929	$9,839,919
Non-income producing	$0	$329,462	$724,815	$1,186,062	$1,713,200
Mill Credit					
Income producing	$0	$5,227,457	$6,272,949	$7,318,440	$8,363,931
Non-income producing	$0	$186,695	$410,729	$672,102	$970,813
Total Cost	**$0**	**$11,893,563**	**$14,788,432**	**$17,786,533**	**$20,887,865**

5.3 Revenues of the Mills Bill

It is not a surprised that revenues are more complicated to estimate than costs, but they are an important part of the overall picture. A large part of the revenues generated is the income tax revenues from both direct and indirect rehabilitation jobs created. Income tax revenue from indirect jobs created grows cumulatively because these are sustainable jobs that are created—they remain after the building is placed in service. In the short-run, direct rehabilitation jobs are an important source of revenue to the state, but they only last for the time that the rehabilitation work takes place. Similarly, sales tax revenue is a direct result of rehabilitation activity and therefore grows in lock-step with increased mill rehabilitation activity. Finally, local property tax grows cumulatively as time passes because once the property taxes are increased, they stay higher as the building remains in use and surrounding properties continue to have higher values as well.

Table 5.5 Mills Bill Revenue					
FY	05-06	06-07	07-08	08-09	09-10
Direct rehab jobs created	1,599	1,919	2,239	2,558	2,558
Indirect jobs created		922	2,029	3,321	4,797
Direct income tax	$2,238,582	$2,686,298	$3,134,014	$3,581,731	$3,581,731
Indirect income tax		$1,291,489	$2,841,277	$4,649,362	$6,715,745
Sales tax	$807,181	$968,617	$1,130,053	$1,291,489	$1,291,489
Local property tax		$499,683	$1,099,303	$1,798,860	$2,598,354
Total Revenue	**$3,045,763**	**$5,446,088**	**$8,204,648**	**$11,321,442**	**$14,187,319**

5.4 Net Cash Flow and Net Present Value

In the first year that the mills bill in implemented, North Carolina generates about $3 million in revenue. Although the costs of the program grow over time, the revenues also grow over time, creating a net cash flow of approximately -$6.5 million in cash flow for the state of North Carolina. The net present value of the bill over the next five years; however, is just over -$20 million. In other words, the mills bill costs the state approximately $5 million per year over the next five years. With this minor cost, the bill generates $260 million in rehabilitation expenses. The preservation and wealth redistribution benefits of the bill make it well worth the annual $5 million cost.

Table 5.6 Net Present Value of Mill Credit					
FY	05-06	06-07	07-08	08-09	09-10
Net Cash Flow	$3,045,763	($6,447,475)	($6,583,785)	($6,465,091)	($6,700,546)
Net Present Value	**($20,163,721)**				
Total Rehab Expenses 2005-2010	**$261,372,858**				

5.5 Sensitivity Analysis—Credit Pay-in Period

The state's net present value of both the existing rehabilitation tax credit and the proposed mills bill is very sensitive to the number of years in which the credit is taken. It is instructive to consider the effects of legislation that requires that the credits be taken over a period of time rather than in the first year. Table 5.7 considers the net present value of the mills bill under varying assumptions of credit pay in period. If tax credits are required to be taken over a period of 4 or 5 years, the state of North Carolina makes money from enacting the mills bill, as the net present value of the bill is positive! This is principally because of the timing of revenues and costs; the state earns revenues well before it has to pay out the costs of the program.[17]

Table 5.7 Sensitivity of Net Present Value to Credit Pay in Period		
Number of Years to Take Credits*	**NPV**	
1	-$20,163,721	(base case)
2	-$11,795,099	
3	-$4,286,447	
4	$2,392,948	
5	$8,272,630	

* Credits for non-income producing residential are still assumed to be taken over 7 years regardless of what the legislation allows because of the practical constraints associated with the bill. A change in legislation would not affect the time period over which these credits are taken.

[17] Interestingly, these results suggest that the existing historic rehabilitation tax credit makes the state a substantial amount of money because the incentive (or the costs) are not as high as with the mills bill, while the revenues remain the same.

6. Conclusion

While there are still some hurdles for North Carolina's Historic Mill Revitalization bill to be passed, it is nearing passage. This paper attempts to provide some context for that bill, explain how it compares to other state legislation, how the bill got to where it stands today, and what the costs of the bill are likely to be.

From a cost-benefit perspective, I recommend that the bill be passed. Many threatened historic buildings will be saved from demolition and salvage as a result of the bill, benefits of revitalization will be spread throughout the state, and the costs of the bill are a relatively low $20 million.

7. Appendix

Appendix 1. Shortlist of Coalition

	Name	**Organization**
1	Deborah Ross	State legislature
2	Peter Sandbeck	SHPO
3	Frank Gailor	Pilot Mills developer
4	Clay Landers	Atlanta Developer
5	Kirk Carrison	CAHEC
6	Robin Pulver	NC Rural Center
7	Beau Mills	Metropolitan Coalition
8	DeWayne Anderson	Developer in W-S
9	Jon Gauthier	Fannie Mae
10	Steve Schuster	Clearscapes
11	Greg Hatem	Empire Properties
12	Tucker Bartlett	Self-Help
13	Mike Hill	Capitol Broadcasting
14	Peter Duffley	Womble Carlisle
15	Lynn Cowan	Preservation NC

Appendix 2. Agenda for December 10 Initial Meeting

Agenda
Mill Reuse Incentives
December 10, 2004

1. Welcome and Introductions

2. Overview of incentives elsewhere – Andrew Stewart

3. Political considerations from Rep. Deborah Ross – Myrick Howard

4. The need for incentives
    How much incentive is needed?
    Small towns vs. cities?
    Size of buildings?
    Types of buildings?

5. Effective delivery mechanisms for incentives
    Credits? Loans? Loan Guarantees? Grants?

6. Precedents for delivery mechanisms

7. Ideal agency/mechanism for implementation

8. Political strategy

9. Other considerations

10. Assignments/future meeting plans

Appendix 3. Basic Bill Parameters Agreed upon in Initial Meeting

Basic Structure of Textile-Tobacco-Furniture Tax Credit

1. **Eligible Sites.** A site that is designed for use or has in fact been used as a textile, tobacco, or furniture facility, or uses ancillary to it and is located in North Carolina. (Same as SC, but expanded to include tobacco and furniture).
2. **Abandonment Test.** An eligible site must have at least 80% of the facilities continuously closed to business or otherwise nonoperational for a period of at least one year preceding the time at which the determination is to be made. (Same as SC)
3. **5 to 1 years.** Properties using the Textile-Tobacco-Furniture tax credit could use it all in one year rather than spreading the credit out over 5 years.
4. **10% tax credit in Tiers 4-5.** The Textile-Tobacco-Furniture tax credit would be 10% of qualified rehab expenses in tier 4 and 5 counties.
5. **20 % tax credit in Tiers 1-3.** The Textile-Tobacco-Furniture tax credit would be 20% of qualified rehab expense in tier 1-3 counties.
6. **Qualified Rehab Expenses.** All rehab costs except acquisition costs. May include sitework, demo, or new construction where applicable.

Starting Date. July 1, 2005

Appendix 4. Basic Parameters of Bill Agreed upon by Coalition

Email from Myrick Howard: 2/21/05

Friends,

We had a good meeting about the mills incentive legislation on Friday attended by eight people, including one by phone. In summary, here is the gist of what was decided:

1) Support the current draft of the legislation with a few suggestions. We discussed -- and concluded that we did indeed support:

a) Historic industrial buildings only
b) More generous incentives for the less wealthy tiers
c) Broadened use of the credits against taxes other than income
d) Allowing the credits to be taken in one year

2) Support the proposed credit as separate from – taken in lieu of -- the existing tax credits rather than amending the existing credits. Clearer, and less likely to cause problems for the existing credits.

3) Suggest the following changes:

a) Have the $2 million threshold apply to all tiers. It was pointed out that there are smaller mills in small towns in a number of Tier 4 and 5 counties that need help. (For example, Haw River, Gibsonville, Alamance, Graham, and Mebane in Alamance County have important mills that would not reach the $4 million threshold – and their renovation is unlikely soon without further incentives.)

b) Have the owner certify (under threat of penalty) the amount of the expenditure and the two years of vacancy to the administering agencies (State Historic Preservation Office and/or Department of Revenue) rather than have those agencies be responsible for making the certification.

c) Allow the credit to be allocated to a tenant in the case of a long-term lease. (Todd Brockmann will draft the needed sentence.)

4) Describe this legislation in our advocacy as creating a demonstration project for a small subset of important and troubled mills. If the legislation succeeds in stimulating additional investment, then its reasons for success need to be analyzed and applied to other buildings (such as incentives for non-historic mills or the expansion of the existing tax credits to allow its application against taxes other than income).

Thanks for your interest and support. We will try to proceed full steam ahead.

Myrick

Appendix 5. First Draft of Mill Bill

Article 3__.
Mill Revitalization Tax Credits.

§ 105-129.___. Credit for revitalizing a certified textile, furniture or tobacco mill.

(a) Credit. – A taxpayer who improves, renovates or redevelops an eligible site is eligible for a tax credit equal to a percentage of the rehabilitation expenses incurred in regard to the eligible site:

(1) In the event the eligible site is located in a tier one, two or three enterprise area, as defined in G.S. 105-129.3 (determined at the time of the eligibility certification), the amount of the credit shall be equal to twenty percent (20%) of the rehabilitation expenses; or

(2) In the event the eligible site is located in a tier four or five enterprise area, as defined in G.S. 105-129.3 (determined at the time of the eligibility certification), the amount of the credit shall be equal to ten percent (10%) of the rehabilitation expenses. The credit may be claimed in the year in which the eligible site is placed in service. In the event the eligible site is placed in service in two or more phases, the applicable portion of the credit corresponding to each phase of the eligible site may be claimed in the year in which each such phase is placed in service. Any unused portion of the credit may be carried forward for the succeeding nine (9) years. A credit allowed under this Article may not exceed the amount of the tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer. The credit earned pursuant to this subsection is in addition to and does not offset the state historic credit in the event the eligible site also is eligible for the state historic credit. To claim the credit allowed by this subsection, the taxpayer must provide a copy of the eligibility certification and the cost certification obtained from the State Historic Preservation Officer.

(b) Allocation. – Notwithstanding the provisions of G.S. 105-269.15, the credit earned pursuant to this Article by a partnership must be passed through to its partners and may be allocated among any of its partners, including without limitation, an allocation of the entire credit to one partner, in a manner agreed by the partners. A partnership and its partners must include with their tax returns for every taxable year in which an allocated credit is claimed a statement of the allocation made by the partnership and the allocation that would have been required under G.S. 105-269.15.

(c) Tax Credited. – The credits provided in this Article are allowed against the taxes levied in Articles 3, 4 and 8B of this Chapter.

(d) Coordination with the State Historic Credit. – In the event the taxpayer is eligible for the credit under this Article and the state historic credit in regard to the eligible site, G.S. 105-129.37 shall not apply to such taxpayer's state historic credit. The following shall apply in lieu thereof:

(i) The state historic credit shall be allowed against the taxes levied in Articles 3, 4 and 8B of this Chapter; and

(ii) The state historic credit may be claimed in the year in which the eligible site is placed in service. In the event the eligible site is placed in service in two or more phases, the applicable portion of the state historic credit corresponding to each phase of the eligible site may be claimed in the year in which each such phase is placed in service. Any unused portion of the state historic credit may be carried forward for the succeeding nine (9) years.

(e) Definitions. – The following definitions apply in this section:

(1) "Cost certification" means the certification obtained from the State Historic

Preservation Officer certifying the amount of the rehabilitation expenses incurred in regard to the eligible site.

(2) “Eligibility certification” means the certification obtained from the State Historic Preservation Officer indicating that the applicable facilities comprise an eligible site.

(3) “Eligible site” means a site located in North Carolina that (i) is designed for use or has in fact been used as a textile, furniture or tobacco manufacturing facility or uses ancillary thereto and (ii) at least eighty percent of the facilities have been continuously closed to business or otherwise non-operational for a period of at least one (1) year immediately preceding the time at which the eligibility certification is made.

(4) “Partner” means any partner, member or owner of an interest in a partnership.

(5) “Partnership” means any general partnership, limited partnership, limited liability company or any other entity taxed as a partnership pursuant to Subchapter K of the Internal Revenue Code.

(6) “Placed in service” means the date upon which the eligible site is suitable for occupancy for the purposes intended.

(7) “Rehabilitation expenses” means the expenses incurred in the rehabilitation of the eligible site, excluding the cost of acquiring the eligible site or the cost of personal property maintained at the eligible site.

(8) “State historic credit” means the Historic Rehabilitation Tax Credits provided pursuant to Article 3D of this Chapter.

(9) “State Historic Preservation Officer” means the Deputy Secretary of Archives and History or the Deputy Secretary's designee who acts to administer the historic preservation programs within the State.

(f) Rules and Fees. – The North Carolina Historical Commission, in consultation with the State Historic Preservation Officer, may adopt rules needed to administer the certification process required by this section and a schedule of fees for providing certifications required by this Article. In establishing the fee schedule, the Commission shall consider the administrative and personnel costs incurred by the Department of Cultural Resources. An application fee may not exceed one percent (1%) of the completed qualifying rehabilitation expenditures. The proceeds of the fees are receipts of the Department of Cultural Resources and must be used for performing its duties under this Article.

(g) Effective Date. – This Article shall apply to eligible sites or portions thereof placed in service on or after July 1, 2005.

Appendix 6. Most Recent Iteration of Mill Bill

A BILL TO BE ENTITLED

AN ACT TO PROVIDE A TAX CREDIT FOR REVITALIZATION OF HISTORIC MILL FACILITIES AND TO ALLOW TAX CREDITS FOR CERTAIN HISTORIC REHABILITATIONS TO BE TRANSFERRED TO LONG-TERM LESSEES.

Whereas, the State of North Carolina has lost more than 164,000 jobs in the textile industry during the past decade; and

Whereas, the State of North Carolina has also lost large number of manufacturing jobs in other industries such as tobacco and furniture; and

Whereas, the losses of these manufacturing jobs have resulted in the vacancy of numerous mill buildings, many of which are historic; and

Whereas, a large vacant mill can be a cancer in a community, if it remains vacant and unused, resulting in the deterioration of surrounding neighborhoods and commercial districts, crime, vandalism, vagrancy, arson, and a loss of community spirit; and

Whereas, renovated for new adaptive uses or for new industrial or business uses, a large old factory or mill can have significant environmental, economic development, cultural, tourism, tax base, and affordable housing benefits for a community; and

Whereas, the Historic Rehabilitation Tax Credits created by the North Carolina General Assembly in 1997 have proved to be successful in the revitalization of numerous major historic buildings; and

Whereas, additional incentives would help encourage the rehabilitation of the numerous industrial buildings that have been vacated in recent years, especially those in smaller towns and counties that have been hardest hit by the loss of manufacturing jobs; and

Whereas, the rehabilitation of historic buildings has been proven to be a successful economic development strategy for creating jobs and stimulating new investment; and

Whereas, Virginia and South Carolina have each adopted generous incentives for the rehabilitation of similar buildings that are resulting in new investment in their communities; Now, therefore,

The General Assembly of North Carolina enacts:

SECTION 1. Chapter 105 of the General Statutes is amended by adding a new Article to read:

"Article 3H.

"Mill Rehabilitation Tax Credit.

"**§ 105-129.70. Definitions.**

The following definitions apply in this Article:

(1) Certified historic structure. – Defined in G.S. 105-129.35.

(2) Certified rehabilitation. – Defined in G.S. 105-129.36.

(3) Cost certification. – The certification obtained by the State Historic Preservation Officer from the taxpayer of the amount of the qualified rehabilitation expenditures or the rehabilitation expenses incurred with respect to an eligible site.

(4) Eligibility certification. – The certification obtained from the State Historic Preservation Officer that the applicable facility comprises an eligible site and that the rehabilitation is a certified rehabilitation.

(5) Eligible site. – A site located in this State that satisfies all of the following conditions:

a. It was designed for use or was used as a manufacturing facility or for purposes ancillary to manufacturing or as a facility for providing utility services.

b. It is a certified historic structure or a State-certified historic structure.

c. It has been at least eighty percent (80%) vacant for a period of at least two years immediately preceding the time at which the eligibility certification is made.

d. The cost certification documents that the qualified rehabilitation expenditures for a site for which a taxpayer is allowed a credit under section 47 of the Code or the rehabilitation expenses for a site for which the taxpayer is not allowed a credit under section 47 of the Code exceed two million dollars ($2,000,000) for the site as a whole.

(6) Enterprise tier area. – Defined in G.S. 105-129.3

(7) Pass-through entity. – Defined in G.S. 105-228.90.

(8) Qualified rehabilitation expenditures. – Defined in section 47 of the Code.

(9) Rehabilitation expenses. – Defined in G.S. 105-129.36.

(10) State-certified historic structure. – Defined in G.S. 105-129.36.

(11) State Historic Preservation Officer. – Defined in G.S. 105-129.36.

"§ 105-129.71. Credit.

(a) Credit. – A taxpayer who rehabilitates an eligible site is allowed a credit equal to a percentage of the qualified rehabilitation expenditures or the rehabilitation expenses with respect to the eligible site. The credit may be claimed in the year in which the eligible site is placed into service. When the eligible site is placed into service in two or more phases in different years, the amount of credit that may be claimed in a year is the amount based on the qualified rehabilitation expenditures or the rehabilitation expenses associated with the phase placed into service during that year. In order to be eligible for a credit allowed by this Article, the taxpayer must provide to the Secretary a copy of the eligibility certification and the cost certification. The amount of the credit is as follows:

(1) For eligible sites located in an enterprise tier one, two, or three area, determined as of the time the eligibility certification is obtained, for which the taxpayer is allowed a credit under section 47 of the Code, the amount of the credit is equal to forty percent (40%) of the qualified rehabilitation expenditures.

(2) For eligible sites located in an enterprise tier one, two, or three area, determined as of the time the eligibility certification is obtained, for which the taxpayer is not allowed a credit under section 47 of the Code, the amount of the credit is equal to fifty percent (50%) of the rehabilitation expenses.

(3) For eligible sites located in an enterprise tier four or five area, determined as of the time the eligibility certification is obtained, for which the taxpayer is allowed a credit under section 47 of the Code, the amount of the credit is equal to thirty percent (30%) of the qualified rehabilitation expenditures.

(4) For eligible sites located in an enterprise tier four or five area, determined as of the time the eligibility certification is obtained, for which the taxpayer is not allowed a credit under section 47 of the Code, the amount of the credit is equal to forty percent (40%) of the rehabilitation expenses.

(b) Taxes Credited. – The credit allowed by this Article may be claimed against the franchise tax imposed under Article 3 of this Chapter, the income taxes imposed under Article 4 of this Chapter, or the gross premiums tax imposed under Article 8B of this Chapter. The taxpayer may take the credit allowed by this Article against only one of the taxes against which it is allowed. The taxpayer shall elect the tax against which a credit will be claimed when filing the return on which it is claimed. This election is binding. Any carryforwards of the credit must be claimed against the same tax.

(c) Cap. – A credit allowed under this Article may not exceed the amount of the tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by or on behalf of the taxpayer. Any unused portion of the credit may be carried forward for the succeeding nine years.

(d) Allocation. – Notwithstanding the provisions of G.S. 105-131.8 and G.S. 105-269.15, a pass-through entity that qualifies for the credit provided in this Article may allocate the credit among any of its owners without limitation. Owners to whom a credit is allocated are allowed the credit as if they had qualified for the credit directly. A pass-through entity and its owners must include with their tax returns for every taxable year in which an allocated credit is claimed a statement of the allocation made by the pass-through entity and the allocation that would have been required under G.S. 105-131.8 or G.S. 105-269.15.

(e) Long-term Leases. – If a taxpayer is eligible for a credit under Section 47 of the Code with respect to property for which the taxpayer is eligible for a credit under this section and the taxpayer elects, pursuant to Section 50(d)(5) of the Code, to transfer the federal credit to a lessee of the property, the taxpayer may elect to transfer the credit allowed by this section to the lessee. If a credit is transferred to a lessee under this subsection, the lessee may take the credit subject to the provisions of this Article.

"**§ 105-129.72. Coordination with Article 3D of this Chapter.**

A taxpayer that claims a credit under this Article may not also claim a credit under Article 3D of this Chapter with respect to the same activity. The rules and fee schedule adopted under G.S. 105-129.36A apply to this Article."

SECTION 2. G.S. 105-129.35 is amended by adding a new subsection to read:

"(d)	Long-term Leases. – If a taxpayer elects, pursuant to Section 50(d)(5) of the Code, to transfer the credit allowed under Section 47 of the Code to a lessee of the property, the taxpayer may elect to transfer the credit allowed by this section to the lessee. If a credit is transferred to a lessee under this subsection, the lessee may take the credit subject to the provisions of this Article."

SECTION 2. This act is effective for taxable years beginning on or after January 1,

2006, and applies to eligible sites placed into service on or after that date.

Appendix 7. Mills Bill Cost and Revenue Projection

ASSUMPTIONS

Mill Profile

	# of Mills	Rehab costs	Total per year
>2 million <5 million	2.7	$3,599,589	$9,598,904
>5 million <10 million	1.3	$6,877,402	$9,169,869
>10 million <20 million	2.3	$13,870,034	$32,363,413
>20 million	0.3	$25,558,260	$8,519,420
Total per year	6.666666667		**$59,651,606**
Average mill rehab		$8,947,741	
Median large rehab		$7,687,437	
Percentage of Mills in Tiers 1-3	70%		
Percentage of Mills in Tiers 4-5	30%		**Estimated SF**
Number of mills done per year	05-06	5	384,372
	06-07	6	461,246
	07-08	7	538,121
	08-09	8	614,995
	09-10	9	691,869
Average Mill Rehab period	12	months	
Estimated value of finished space	$100	per sf	
Commercial Space (Income producing)	60%	estimated sf	
Residential Apartments (Income producing)	20%	estimated sf	
Residential Condos (Non-income producing)	20%	estimated sf	

Revenue Assumptions

Direct rehab jobs	41.6	per $1 million in rehab expenses
Indirect jobs created by businesses in space	1	per 250 sf commercial space
Direct income tax increase	$1,400	per job created
Sales tax	7%	
Percent of Rehab expenses subject to sales tax	30%	rehab expenses
Property Tax assessed direct value increase	80%	rehab expenses
Surrounding property tax assessed value increase	50%	rehab expenses
Property tax rate	$1	per $100 in tax assessed value
Net Present Value Discount Rate	5%	

NC State Tax Credits

		Years to use credit	
Federal Historic	20%	1	year(s)
Existing NC Historic (Income producing)	20%	1	year[s]
Existing NC Historic (Residential condo)	30%	7	year[s]
Tier 1-3 Mill (Income producing)			
Income producing	20%	1	year[s]
Non-income producing	20%	7	year[s]
Tier 4-5 Mill			
Income producing	10%	1	year[s]
Non-income producing	10%	7	year[s]

PROJECTIONS

NC State Cost

FY	05-06	06-07	07-08	08-09	09-10
Rehab expenses	$38,437,185	$46,124,622	$53,812,059	$61,499,496	$61,499,496
Existing Historic Credit					
Income producing	$0	$6,149,950	$7,379,940	$8,609,929	$9,839,919
Non-income producing	$0	$329,462	$724,815	$1,186,062	$1,713,200
Mill Credit					
Income producing	$0	$5,227,457	$6,272,949	$7,318,440	$8,363,931
Non-income producing	$0	$186,695	$410,729	$672,102	$970,813
Total Cost	**$0**	**$11,893,563**	**$14,788,432**	**$17,786,533**	**$20,887,865**

State and Local Government Revenue

FY	05-06	06-07	07-08	08-09	09-10
Direct rehab jobs created	1,599	1,919	2,239	2,558	2,558
Indirect jobs created		922	2,029	3,321	4,797
Direct income tax	$2,238,582	$2,686,298	$3,134,014	$3,581,731	$3,581,731
Indirect income tax		$1,291,489	$2,841,277	$4,649,362	$6,715,745
Sales tax	$807,181	$968,617	$1,130,053	$1,291,489	$1,291,489
Local property tax		$499,683	$1,099,303	$1,798,860	$2,598,354
Total Revenue	**$3,045,763**	**$5,446,088**	**$8,204,648**	**$11,321,442**	**$14,187,319**

Net Present Value of Mill Credit

FY	05-06	06-07	07-08	08-09	09-10
Net Cash Flow	$3,045,763	($6,447,475)	($6,583,785)	($6,465,091)	($6,700,546)
Net Present Value	**($20,163,721)**				
Total Rehab Expenses	**$261,372,858**				
2005-2010					

NOTES

1. Projections based on **median** mill rehab cost (highlighted in yellow)
2. Non-income producing credits taken in 7 years because individual taxpayers are beneficiaries
3. Cells in blue text are inputs to the model. They may be changed for sensitivity analysis
4. Indirect jobs created are sustained after they are created
5. Direct rehab jobs last 1 year (average mill rehab period)
6. Costs to state of NC are delayed 1 year because credits are claimed upon rehab completion

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